

---

## RECENT CHANGES IN THE CONTEMPORARY BANKING SYSTEMS AND THEIR IMPLICATIONS

---

**SBÂRCEA Ioana Raluca**

**Abstract:**

*The current banking systems have lately passed through several transformations, embodied in the increased number of bank mergers and take-over and creating of internationally famous financial groups, most of which are present on the Romanian market. These changes have determined new orientations of the activities and functions which the banks hold in an economy and relate mainly to the banking deregulation, the use of the financial innovation, the globalization and the securitization of bank assets. All these features of the current banking systems, on one hand aimed at reducing the bank risk through a better capitalization of the banks consortia and thus feeling less acute the various risk-generating events and on the other hand, they represent one of the causes of a resounding financial crisis, as the one that the economies of the world are passing through today, given the effects that the bankruptcy of an international bank consortium can have over the global economy. Given these issues, in the international context of the banking systems, an identification is required and a correct assessment of the risks associated with the banking activity, in order to adopt the necessary measures for reducing them and their potential effects.*

**Keywords:** *modern banking systems, securitization, globalization, the current financial crisis, banking concentration, mergers and acquisitions*

The contemporary banking systems located in the developed countries have undergone radical changes which have brought new banking products and services through which the banks have tried to increase their profits and their market share.

Referring to the current conditions, for studying the structure and the activity of banks, we take into account certain processes of profound significance, from which:

- Banks appear, more and more, as financial intermediaries with specific character;
- The process of competition in the Western banking systems and the trends towards economic and monetary integration are being emphasized;
- The transition from the centrally planned economy to the market economy involves restructuring the overall banking activity in countries where it is made.

All institutions and activities that ensure the transfer of funds that are available in certain areas to other sectors of activity which record a deficit of resources, characterizes the activity of financial intermediation (Negruș, Mariana, 2008, pg. 20).

*Financial intermediation* has an important role especially in the developed and the developing countries, so that these financial actors develop their activity after certain reglementations regarding the authorization, the functioning and the activities they may carry.

In the modern economies, the borrower and the lender agents meet via two funding circuits:

- **direct financing**: as bilateral transactions between the surplus agents, in the securities market (for direct subscription to the issued shares and bonds);
- **indirect or intermediated financing**: in which case a financial intermediary falls between debtors and creditors. Therefore the role of the financial intermediaries is that they give compatibility to the request and offer expressed by the agents in the economy, transforming the characteristics of the debts and of the claims of the non-financial agents.

Starting from the financial intermediary role fulfilled by banks, an interesting issue for analysis is that of the current guidelines of the modern banking systems.

The banking systems from the developed countries went through a series of mutations or changes, which determined new guidelines of the activity and functions that they have in an economy. Factors behind these changes relate mainly to **the financial innovations** in the banking domain, which were possible because of the development of the information technology, of the **deregulation**, the **globalization** and the **securitization of bank assets**. These changes have occurred as a result of the sharp rise in bank competition, which resulted in an increase in the interest for innovation of the offered products and services, so as to meet the demand of a most diverse range of clients.

The *financial innovation* defines the creation process (development) of some new financial products; in a larger sense, are embedded some new ways to place funds, or the development and evolution of some new financial bodies. Consequently, the financial innovation manifests itself at the level of the whole financial market, therefore also at the level of the banking products and services market (examples of such financial innovations are: interest rate swap, the use of the credit derivatives, the securitization of loans, the debit cards, the intensive use of the Internet-banking, etc..).

In the specialty literature, a distinction is made in the process of financial innovation, between the *products innovations* – that lead to the emergence of new financial instruments - and the *processes innovations* - resulting in the emergence of new financing techniques. A classification of the financial innovations based on the nature of the institutions involved in the process, makes the distinction between the *system innovations* - a result of the activity of the economic agents - and the *policy innovations* - belonging to the state authorities (Stoica, O., 2005/2006, pg. 77-78).

The reason why these innovations appeared is on one hand, the banks intention to bypass the existing regulations but at the same time it reflects the process

of the economic development, and aim to the banks attempts to constantly obtain greater earnings, to maintain their clients offering them cheaper products and services than the competing banks. Implementation of the financial innovations was possible in the context of a constant development of the information technology and of the computer software used by banks. Thus, the financial and banking institutions were always concerned with the purchase of more efficient computer programs, that would provide them national and international inter- and intra-bank connectivity and a real time connection with clients, this would allow the clients to carry out transactions without having contact with the bank officials.

Starting from the observation that the *regulations (excessive) may act as barriers to the entrance in the financial markets and thus limit the competition*; in this area the current of the *deregulation* has also manifested itself. Basically, the deregulation does not imply a waiver of regulations, but creating new rules that provide a competitive position of the banks that do not restrict the competition towards the other financial institutions.

*The deregulation has generally encouraged the financial innovation, but sometimes the excessive regulations were the starting point for the emergence of new financial products*, in other cases, the "struggle" between the financial intermediaries and the financial market regulators ended with a process of re-regulation.

The financial regulation of banking has been subjected to a continuous change, which has had two essential purposes:

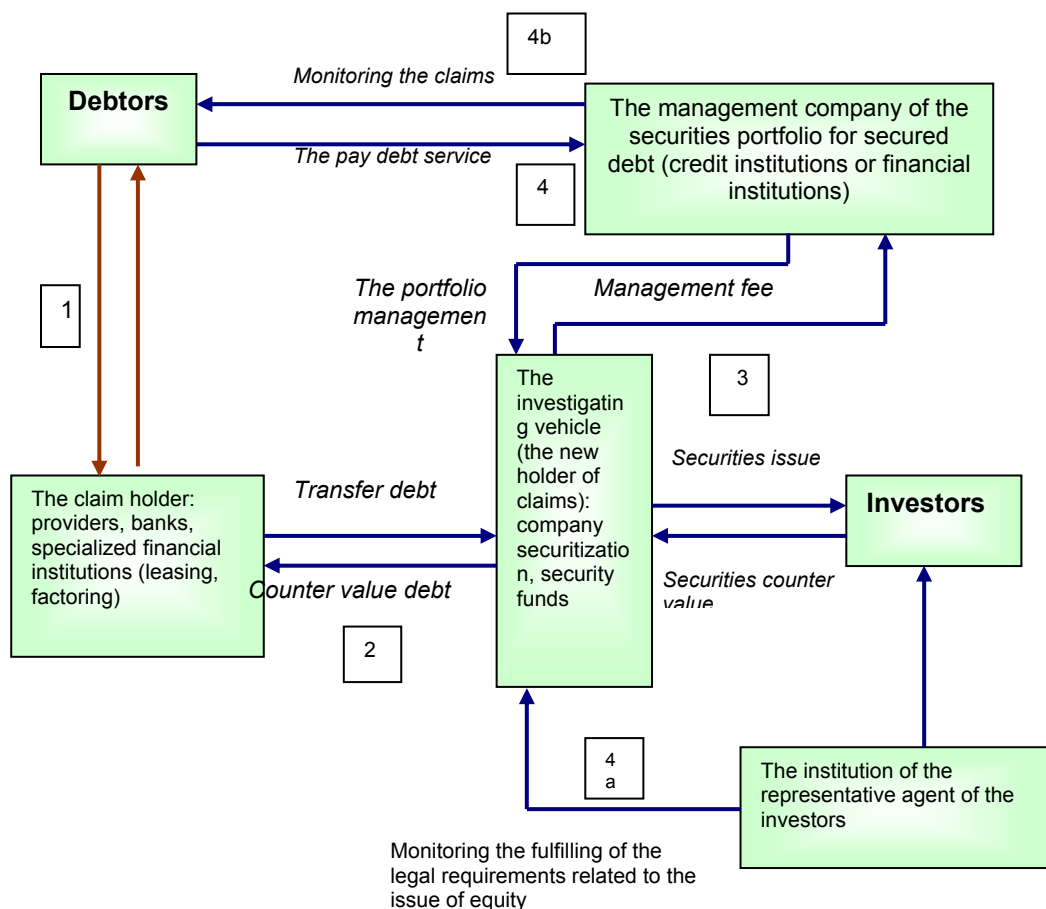
- I. the international regulation of the banking activities, to facilitate the process of extending their business outside their home country and the implementation of a system of banking supervision that would be valid for any banking entity, regardless of its geographical location ( the Basel I and Basel II);
- II. the regulation of the financial groups, with the development of the financial conglomerates, consisting of commercial banks, to which have been added insurance companies, financial investment companies, leasing companies, mutual funds, the need for elaborating some regulations that ensure the traceability of the activity of these financial entities was felt.

The lending activity of the commercial banks has undergone many changes and of these, *the securitization* is regarded as one of the most revolutionary changes. Through this transaction, the commercial banks have found the possibility of reducing the interests on loans, namely to increase the number of customers attracted, without reducing their incomes. Thus, the interest incomes were replaced by revenues from fees from the securitization transactions.

These operations have been achieved at first for mortgages / real estate credits, and consisted in the assembly of bank loans with common features in debt portfolios which are sold to an entity (named the investment vehicle) in order to issue financial instruments for sale on the financial market; today these operations have extended to a wider range of claims.

The securitization transaction virtually transforms some unsaleable assets (loans) in negotiable assets (securities) (chart. 1). Thus, it is done a gradual shift from

financing the credits from attracted deposits to financing them from the amounts invested in the property values market; and from the rates and loan interest paid by the credit holders, the securities are redeemed and the interest (coupons) related are paid.



**Chart. 1 – The mechanism to secure claims** (Georgescu, F.,2004, www.bnro.ro)

The globalization is another factor which has effects that are increasingly felt over the modern banking systems. The phenomenon of globalization has begun to develop with the first branches of some banks that were opened abroad. This, in addition to the transfer of cash effect from one country to another country, also has effects related to the change of the banking culture, to the way the products are approached, the way the clients are served, and the banking management. So, lately, we are witnessing the creation of a new culture of global investment, and in particular the creation of a new global banking culture that finds its way through *financial innovations* which from the perspective of the globalization can be seen like an effect of the meeting of several banking experts from different countries that have created new products that incorporate the international banking experience.

The factors that have driven the international banking system, led to mutations in these systems, which have had implications over their current features, from which the following are noticeable: *diversity, concentration, speeding up the restructuring operations.*

- *The diversity of a banking system* lies in the existence of an increased number of banks and credit institutions defined by the banking law and whose characteristics can be different. In a banking system are found both specialized agencies in a particular type of clientele or business, and banks with universal activity. Depending on the size of the banks, a banking system may include small-scale banks and banks of international dimension. The diversity can be approached also from the perspective of a wide variety of products and services that can be currently offered to customers, as an effect of the financial innovations that occurred in the last period.
- *Concentrating the banking activity* is a characteristic that is measured by the share held by the major banks in the total banking system and by reducing the number of banks in their total. The degree of concentration is assessed by the level of the activity (distribution of loans, collection of deposits) made by banks and credit institutions. Studies show that a few banks control, largely, the banking market. Between the degree of concentration of the banking activities and the number of the banking institutions there is a strong connection, as follows: as the number of banks is decreasing, the level of the bank concentration increases. The banking concentration is a result of the globalization, which allowed the penetration of some strong banks with international experience in the developing countries, the market seizure and crushing competition in those countries.
- *Restructuring the bank* (Toma, R., 2007, pg. 78) is another feature of the current banking systems, in them being included the mergers and the absorptions, the cross-border transactions (with other countries), the acquisition of the control package by foreign banks and the cross-bank-insurance operations. The bank restructurations have represented for banks a way of touching an optimum size, which ensures: eliminating additional costs due to the organization of the production, depreciating on a large scale of the investments in the new technologies and extending the product range offered to customers in order to remain competitive. From the effects of restructuring is necessary to bring the issue of intensifying the competition.

Thus, the international banking systems have undergone a series of changes brought about by two key directions, respectively:

- **mergers and acquisitions** in banking, which led to increasing of the concentration degree of bank assets and forming large banking groups;
- **creation of financial consortia**, resulted in that bank shareholders have decided to create some financial companies, insurance companies, financial investment and leasing companies, so that the range of products and services offered by the commercial banks have seen a substantial increase.

Mergers and acquisitions worldwide have generally had a strong dynamic; this was also reflected by the large number of such transactions and their value. According to the UNCTAD (United Nations Conference on Trade and Development) in 2006, the trans-border mergers and acquisitions increased by 23%, or 880 billion dollars, and as for the number of transactions, they increased by 14% compared to 2005, namely with 6974 transactions.

Mergers and acquisitions in the financial services, in general, and in the banking system, in particular, *represent a global phenomenon*, with a significant increase each year. The main actors in the processes of mergers and acquisitions are mainly ***banks operating in the developed countries*** by penetration in the developing economies or the less developed. For example, HSBC Holdings of Britain, which occupied first place among the most powerful 1000 banks worldwide, in 2008 has expanded its strategic activities in Taiwan, Korea and Russia. Then UniCredit began the expansion strategy in Central Asia, while Commerzbank acquired a bank in Ukraine, and Deutsche Bank has strengthened its position in China, expansion of the business lines at the Hua Xia Bank (UNCTAD – “World Investment Report 2007 – 2008”, [www.unctad.org](http://www.unctad.org)).

With regard to the European banks, it is noted that in the period 1999-2003, extending outside the country of origin, was intended to *develop new sectors* (management of assets or investments), while during the more recent period, the focus has moved to the retail banks, the goal being to *obtain a well-developed distribution network*. Mergers or acquisitions initiated by the European banks, outside the European Union borders recorded a large increase in 2005 as the European Central Bank reports (table no. 1) show. For example, the British banks have expanded in South Africa, Malaysia or Korea and Austrian banks have expanded in Romania (which at that time was not an EU member). The explanation for this may be on the one hand, increasing the financial power of these banks, and second, the potential growth and development in these countries.

**Table 1 - The main transactions carried out in 2000-2006, between the European banks:**

Year	Acquirer	Targeted bank	Acquisition value (billion euro)
2006	Credit Agricole (France)	Emporiki (Greece)	3,3
2006	BNP Paribas (France)	Banca Nazionale del Lavoro (Italy)	10,0
2005	Unicredito (Italy)	HVB (Germany)	13,3
2005	ABN Amro(Netherlands)	Banca Antoveneta (Italy)	6,1
2005	Unicredito (Italy)	Bank Austria CA (Austria)	2,1
2001	HVB (Germany)	Bank Austria CA (Austria)	7,8
2001	Dexia BIL (Luxembourg)	Kempen&Co (Belgium/Netherlands)	1,1
2000	Fortis Bank (Belgium/Netherlands)	BGL (Luxembourg)	1,6

BCE – “Financial integration in Europe”, march 2007, [www.ecb.int](http://www.ecb.int)

These structural changes caused by acquisitions and mergers in the banking sector, are made in order to *obtain different competitive advantages in the market*,

namely: it may follow the increase of the size of an existing institution, an institution that is in difficulty can be saved, the activity of an institutions can be perfected in a particular area by the combination of knowledge and experience with those of other institutions, the access to other markets in other countries can be easy, namely the access to new customers, the activity of an institution can be diversified through entering other sectors and ensuring a faster development of them. Also, an advantage of these mergers and acquisitions is increasing the market competition, by the entry of strong competitors. But mergers and acquisitions are not without risks, which can be analyzed according to the type of transaction that occurs (table no. 2).

**Table 2 - The risks of bank mergers and acquisitions**

The type of transaction	The risk
<i>Mergers and acquisitions between banks in the same country</i>	<ul style="list-style-type: none"> <li>- the risk before the transaction is related to the price of the transaction and to the possibility of strategic risks;</li> <li>- the risk after the transaction is an operational risk, related to the integration of the personnel, the management of the systems and the information management and risk procedures;</li> </ul>
<i>Mergers and acquisitions between banks in different countries</i>	<ul style="list-style-type: none"> <li>- the risk before the transaction is all about the price of the transaction and about the possibility of strategic risks, but is higher due to barriers and cultural differences;</li> <li>- the risk after the transaction is one operational, and also one connected with the fact that two institutions from different countries must comply with tax requirements, accounting regulations and different reporting requirements.</li> </ul>

Thus, restructuring the banking system through the mergers and transactions at national and international level, carried out at a rate soared in recent years, *generates competitive advantages in the market*, but also **serious risks** caused by the concentration of the banking assets on a reduced number of banks and substantial losses if the bank consortia fail, which is why the awareness and the proper management of the banking risks is essential for the sustainable development of the companies, in particular, and of the economies in general.

Therefore, the international banking system has undergone radical changes, which were based on the permanent desire of the banks to increase their earnings, which was achieved both by increasing the range of products and services and their continuous innovation and also by the penetration of other markets, which gave them access to an increasingly diversified range of customers.

All these mutations in the banking system, in addition to the beneficial effects they have had (for example, *implementing the internet-banking, the mobile banking which have facilitated a quicker access to the banking products, the possibility for the same financial group to provide the full range of financial products to a customer, increased competition which enabled customers to enjoy the cheapest products*) also



caused negative effects, including the most recently, with significant effects on the global economy, the **international financial crisis** which had its origin in the banking system.

Although the **financial crisis** has manifested by a sharp drop in the U.S. housing prices or the collapse of the housing credit market, the causes for the outbreak are many more and much more complex and are both of *microeconomic and macroeconomic nature*. The underlying cause of the financial crisis was the abundant liquidity created by the world's main central banks (FED - U.S. Central Bank, BOJ - Central Bank of Japan) and by the desire of the countries that export oil and gas to limit the currency appreciation. Also, there was a over saturation with savings generated by the increasing integration into the global economy of some countries (China, Southeast Asia in general), with high rates of accumulation, but also by the global redistribution of wealth and income towards the supply exporters (oil, gas, etc.). The abundant liquidity and the over saturation with savings created available resources for investments, including *sophisticated financial instruments*, more difficult to understand for some investors. The consequences of the abundant liquidity were the very low interest rates and their low volatility. Together, these consequences have led to the increased appetite for assets with large gains. In addition, the low market volatility has created the tendency to underestimate the risk and a real lack of vigilance from the investors, on the base of an insufficient understanding of the risks they subject themselves to (Isărescu, M. - Criza financiară internațională și provocări pentru politica monetară din România, Disertație susținută cu ocazia decernării titlului de Doctor Honoris Causa al Universității Babeș-Bolyai, Cluj-Napoca, 26.02.2009, [www.bnro.ro](http://www.bnro.ro)).

On this background operated, as aggravating, a number of microeconomic causes such as increasing the appetite for securitization; cracks in the business model of the rating agencies, the increased international competition for deregulation (Isărescu, M. – Nouă lecții din actuala criză financiară, discurs susținut la Academia Română, cu ocazia dezbaterii "Ce putem învăța din actuala criză economică?", organizată de Secția de Științe Economice, Juridice și Sociologie a Academiei Române, împreună cu Institutul Național de Cercetări Economice "Costin C. Kirițescu" și Comitetul Național Român "Grupul de reflecție E.S.E.N.", 14.04.2009).

So, although shown briefly, we understand that the financial crisis was the effect of some items that are found in what I called mutations in the contemporary banking. Thus, a banking system spread worldwide, operating after regulations increasingly sketchy, allowing banks to increase competition, and which generated products more and more complex, thanks to the financial innovations, has made possible a **pervasive financial crisis**, which today is a crisis of the economies of all countries, because the role and the impact that a banking system has is very important one. Thus, we currently discuss the lack of liquidity in the banking system, a reduced confidence for credit, the difficulties of companies to finance their business, the increases in unemployment, the reductions in consumption, the increasing of the default bank credit, practically we discuss the spreading of the crisis effects that started



from the banking system over the whole economy, respecting the principle of a domino game.

In present, at international level, *solution for getting out of this financial crisis* are being searched, that are mainly aimed at *restoring the investors and the consumers confidence* and this process can be lengthy. These solutions aim not necessarily at the dispense of the new financial products and services that had an important role in triggering the crisis, and rather a *way of increasing regulation and supervision of their operation*, and a *knowledge of the risks that are subjected to from the investors* so they can reduce or prevent them. But these purposes of the recovery policies are the ultimate goals. First, the governments of all countries seek solutions to resolve the problems that the companies and the people are faced with; with the social problems related to the growing number of the unemployed, correlated with their reduced ability to pay loans and then with the problems faced by banks to honor their debts. However they are viewed, both causes and solutions of getting out of this crisis are related to the existing risks in the financial domain and to restoring the "confidence" in this system, which is very important in the international economic and investment environment.

#### **References:**

- ❖ Georgescu, F. - *Armonizarea legislației bancare la cerințele comunitare* - Ediția a VII-a a "FORUMULUI BANCAR ROMÂN", 16 November 2004, [www.bnro.ro](http://www.bnro.ro)
- ❖ Isărescu, M. - *Criza financiară internațională și provocări pentru politica monetară din România*, Disertație susținută cu ocazia decernării titlului de Doctor Honoris Causa al Universității Babeș-Bolyai, Cluj-Napoca, 26.02.2009, [www.bnro.ro](http://www.bnro.ro)
- ❖ Isărescu, M. – *Nouă lecții din actuala criză financiară*, discurs susținut la Academia Română, cu ocazia dezbaterii "Ce putem învăța din actuala criză economică?", organizată de Secția de Științe Economice, Juridice și Sociologie a Academiei Române, împreună cu Institutul Național de Cercetări Economice "Costin C. Kirițescu" și Comitetul Național Român "Grupul de reflecție E.S.E.N.", 14.04.2009
- ❖ Stoica, O. – *Inovația financiară și dezvoltarea piețelor de capital*, Analele Universității Al. I.Cuza din Iași, Tomul LII/LIII, 2005/2006
- ❖ Negruș, Mariana – *Produse și servicii bancare*, marketing bancar, Editura Fundației România de Mâine, București, 2008
- ❖ Toma, R. – *Politici și tehnici bancare*, Editura Univ. „Lucian Blaga”, Sibiu, 2007
- ❖ \*\*\*UNCTAD – “*World Investment Report 2007 – 2008*”, [www.unctad.org](http://www.unctad.org)
- ❖ \*\*\*BCE – “*Financial integration in Europe*”, march 2007, [www.ecb.int](http://www.ecb.int)